



Testimony before the Committee on  
Oversight and Government Reform,  
House of Representatives

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# REBUILDING IRAQ

## Reconstruction Progress Hindered by Contracting, Security, and Capacity Challenges

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Highlights of [GAO-07-426T](#), a testimony before the Committee on Oversight and Government Reform, House of Representatives

## Why GAO Did This Study

The Department of Defense (DOD) has relied extensively on contractors to undertake major reconstruction projects and provide support to its deployed forces, but these efforts have not always achieved desired outcomes. Further, the Iraqi government must be able to reduce violence, sustain reconstruction progress, improve basic services, and make a positive difference in the daily lives of the Iraqi people.

This statement discusses (1) factors affecting DOD's ability to promote successful acquisition outcomes on its contracts for reconstruction and for support to deployed forces in Iraq, (2) the deteriorating security situation and the capabilities of the Iraqi security forces, and (3) issues affecting the Iraqi government's ability to support and sustain future reconstruction progress.

The testimony is based upon our work on Iraq reconstruction and stabilization efforts, DOD contracting activities, and DOD's use of support contractors spanning several years. This work was conducted in accordance with generally accepted government auditing standards.

## What GAO Recommends

GAO is making no new recommendations in this testimony. GAO has previously made numerous recommendations to improve DOD's management and use of contracts. DOD has generally agreed with these recommendations and has taken some actions to implement them.

[www.gao.gov/cgi-bin/getrpt?GAO-07-426T](http://www.gao.gov/cgi-bin/getrpt?GAO-07-426T).

To view the full product, including the scope and methodology, click on the link above. For more information, contact Katherine V. Schinas at (202) 512-4841 or [schinasik@gao.gov](mailto:schinasik@gao.gov).

# REBUILDING IRAQ

## Reconstruction Progress Hindered by Contracting, Security, and Capacity Challenges

### What GAO Found

The challenges faced by DOD on its reconstruction and support contracts often reflect systemic and long-standing shortcomings in DOD's capacity to manage contractor efforts. Such shortcomings result from poorly defined or changing requirements, the use of poor business arrangements, the absence of senior leadership and guidance, and an insufficient number of trained contracting, acquisition and other personnel to manage, assess and oversee contractor performance. In turn, these shortcomings manifest themselves in higher costs to taxpayers, schedule delays, unmet objectives, and other undesirable outcomes. For example, because DOD authorized contractors to begin work before reaching agreement on the scope and price of that work, DOD paid millions of dollars in costs that were questioned by the Defense Contract Audit Agency. Similarly, DOD lacks visibility on the extent to which they rely on contractors to support their operations. When senior military leaders began to develop a base consolidation plan, officials were unable to determine how many contractors were deployed and therefore ran the risk of over- or under-building the capacity of the consolidated bases.

U.S. reconstruction efforts also continue to be hampered by a security situation that continues to deteriorate. Although the number of trained and equipped Iraqi security forces increased to about 323,000 in December 2006 and more Iraqi Army units have taken the lead for counterinsurgency operations, attacks on coalition and Iraqi security forces and civilians have all increased. Aggregate numbers of trained and equipped Iraqi forces, however, do not provide information on the capabilities and needs of individual units. GAO has made repeated attempts to obtain unit-level Transition Readiness Assessments (TRAs) without success. This information is essential for the Congress to make fully informed decisions in connection with its authorization, appropriations, and oversight responsibilities.

As the U.S. attempts to turn over its reconstruction efforts, the capacity of the Iraqi government to continue overall reconstruction progress is undermined by shortfalls in the capacity of the Iraqi ministries, widespread corruption and the inability to fund and execute projects for which funds were previously budgeted. Iraqi government institutions are undeveloped and confront significant challenges in staffing a competent, nonaligned civil service; using modern technology; and managing resources and personnel effectively. For example, according to U.S. officials 20 to 30 percent of the Ministry of Interior staff are "ghost employees" whose salaries are collected by other officials. Further, corruption in Iraq poses a major challenge to building an effective Iraqi government and could jeopardize future flows of needed international assistance. Unclear budgeting and procurement rules have affected Iraq's efforts to spend capital budgets effectively and efficiently, according to U.S. officials. At the Ministry of Oil, for example, less than 1 percent of the \$3.5 billion budgeted in 2006 for key enhancements to the country's oil production, distribution, and export facilities, had been spent as of August 2006.

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Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss (1) factors affecting the Department of Defense's (DOD) ability to promote successful acquisition outcomes on its contracts for reconstruction and for support to deployed forces in Iraq, (2) the deteriorating security situation and the capabilities of the Iraqi security forces, and (3) issues affecting the Iraqi government's ability to support and sustain future reconstruction progress. Prudence with taxpayer funds and growing long-range fiscal challenges demand that DOD maximize its return on the billions of dollars it has invested in reconstruction projects and support contracts. Further, strengthening Iraq's fragile government institutions, which have thus far failed to adequately deter corruption, stimulate employment, or deliver essential services is critical to establishing a peaceful, stable, and secure Iraq.

DOD has relied extensively on contractors to undertake major reconstruction projects and provide support to its troops, but these efforts have not always achieved desired outcomes or achieved such outcomes in an economic and efficient manner. The challenges encountered in Iraq are emblematic of a range of systemic and long-standing challenges faced by DOD. In this regard, we identified DOD contract management to be high risk because of its vulnerability to fraud, waste, abuse, and mismanagement 15 years ago and have reported on DOD's long-standing problems with management and oversight of support contractors since 1997. In a report issued in July 2006, we concluded that with awards to contractors large and growing, DOD will continue to be vulnerable to contracting fraud, waste or misuse of taxpayer dollars, and abuse.<sup>1</sup> While DOD has acknowledged its vulnerabilities and taken some actions to address them, many of the initiatives are still in their early stages and it is too soon to tell what impact they may have.

The Iraqi situation is more complicated as the United States must rely on the Iraqi government to play a larger role, which will require capacity not yet present. As we previously reported, amid signs of progress, the coalition faces numerous political, economic, and security challenges in rebuilding Iraq. In addition, the continued violence increases the risk that the United States will not be able to complete remaining reconstruction

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<sup>1</sup>GAO, *Contract Management: DOD Vulnerabilities to Contracting Fraud, Waste, and Abuse*, [GAO-06-838R](#) (Washington, D.C.: July 7, 2006).

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projects as planned and threatens the Iraqi government's ability to provide essential services to the Iraqi people.

This testimony is based upon GAO's extensive work on Iraq reconstruction and stabilization efforts, DOD contracting activities, and DOD's use of support contractors spanning several years. This work was conducted in accordance with generally accepted government auditing standards.

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## Summary

The challenges faced by DOD on its reconstruction and support contracts often reflect systemic and long-standing shortcomings in DOD's capacity to manage contractor efforts. Such shortcomings result from various factors, including poorly defined or changing requirements; the use of poor business arrangements; the absence of senior leadership and guidance; and an insufficient number of trained contracting, acquisition, and other personnel to manage, assess, and oversee contractor performance. In turn, these shortcomings manifest themselves in higher costs to taxpayers, schedule delays, unmet objectives, and other undesirable outcomes. For example, because DOD authorized contractors to begin work before reaching agreement on the scope and price of that work, DOD paid millions of dollars in incurred costs that were questioned by the Defense Contract Audit Agency. A DOD contracting official noted that the payment of incurred costs is required for cost-type contracts, absent unusual circumstances. Similarly, DOD lacks visibility on the extent to which it relies on contractors to support its operations. In turn, when senior military leaders began to develop a base consolidation plan, officials were unable to determine how many contractors were deployed and therefore ran the risk of over- or under-building the capacity of the consolidated bases. With about 29 percent of DOD's planned construction work remaining and the need for continued support for deployed forces, it is essential for DOD to address these shortcomings if the department is to increase its return on its investment in Iraq.

U.S. reconstruction efforts also continue to be hampered by a security situation that continues to deteriorate. Although the number of trained and equipped Iraqi security forces has increased from about 174,000 in July 2005 to about 323,000 in December 2006, and more Iraqi Army units have taken the lead for counterinsurgency operations, attacks on coalition and Iraqi security forces and civilians have all increased. Consequently, U.S. forces have continued to conduct combat operations in urban areas, especially Baghdad. Aggregate numbers of trained and equipped forces do not provide information on the capabilities and needs of individual units. Rather, this information is found in unit-level Transition Readiness

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Assessment reports that are prepared by coalition advisors embedded in Iraqi units. GAO has made repeated attempts since January 2006 to obtain these assessments without success. These data are essential for the Congress to make fully informed decisions in connection with its authorization, appropriations, and oversight responsibilities.

As the United States attempts to turn over its reconstruction efforts, the capacity of the Iraqi government to continue overall reconstruction progress is undermined by shortfalls in the capacity of the Iraqi ministries, widespread corruption, and the Iraq government's inability to fund and execute projects for which funds were previously budgeted. Iraqi government institutions are undeveloped and confront significant challenges in staffing a competent, non-aligned civil service; using modern technology; and managing resources and personnel effectively. For example, according to U.S. government reports and international assessments, ministry personnel are frequently selected on the basis of political affiliation rather than competence or skills, and some ministries are under the authority of political parties hostile to the U.S. government. Further, according to U.S. officials, 20 to 30 percent of the Ministry of Interior staff are "ghost employees" whose salaries are collected by other officials. Corruption in Iraq poses a major challenge to building an effective Iraqi government and could jeopardize future flows of needed international assistance. According to U.S. officials, unclear budgeting and procurement rules have affected Iraq's efforts to spend capital budgets effectively and efficiently. For example, at the Ministry of Oil, less than 1 percent of the \$3.5 billion budgeted in 2006 for key enhancements to the country's oil production, distribution, and export facilities had been spent as of August 2006.

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## Background

The broader context of U.S. efforts for Iraqi reconstruction is tied to how missions and projects are being conducted and managed. Over the past decade, DOD has increasingly relied on contractors to provide a range of mission-critical services. Overall, DOD's obligations on service contracts rose from \$82.3 billion in fiscal year 1996 to \$141.2 billion in fiscal year 2005. According to DOD officials, the amount obligated on service contracts exceeded the amount the department spent on major weapon systems.

The growth in spending for services has coincided with decreases in DOD's workforce. DOD carried out this downsizing, however, without ensuring that it had the specific skills and competencies needed to accomplish DOD's mission. For example, the amount, nature, and

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complexity of contracting for services have increased, which has challenged DOD's ability to maintain a workforce with the requisite knowledge of market conditions and industry trends, the ability to prepare clear statements of work, the technical details about the services they procure, and the capacity to manage and oversee contractors. Participants in an October 2005 GAO forum on Managing the Supplier Base for the 21<sup>st</sup> Century commented that the current federal acquisition workforce significantly lacks the new business skills needed to act as contract managers.

Contractors have an important role to play in the discharge of the government's responsibilities, and in some cases the use of contractors can result in improved economy, efficiency, and effectiveness. At the same time, there may be occasions when contractors are used to provide certain services because the government lacks another viable and timely option. In such cases, the government may actually be paying more and incurring higher risk than if such services were provided by federal employees. In this environment of increased reliance on contractors, sound planning and contract execution are critical for success. We have previously identified the need to examine the appropriate role for contractors to be among the challenges in meeting the nation's defense and other needs in the 21st century.<sup>2</sup>

The proper role of contractors in providing services to the government is currently the topic of some debate. In general, I believe there is a need to focus greater attention on what type of functions and activities should be contracted out and which ones should not, to review and reconsider the current independence and conflict of interest rules relating to contractors, and to identify the factors that prompt the government to use contractors in circumstances where the proper choice might be the use of civil servants or military personnel. Possible factors could include inadequate force structure; outdated or inadequate hiring policies, classification and compensation approaches; and inadequate numbers of full-time equivalent slots.

Turning to Iraq, DOD has relied extensively on contractors to undertake major reconstruction projects and provide support to its troops. For example, DOD has responsibility for a significant portion of the more than

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<sup>2</sup>GAO, *21st Century Challenges: Reexamining the Base of the Federal Government*, [GAO-05-325SP](#) (Washington, D.C.: February 2005).

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\$30 billion in appropriated reconstruction funds and has awarded and managed many of the large reconstruction contracts, such as the contracts to rebuild Iraq's oil, water, and electrical infrastructure, and to train and equip Iraqi security forces. Further, U.S. military forces in Iraq have used contractors to a far greater extent than in prior operations to provide interpreters and intelligence analysts, as well as more traditional services such as weapon systems maintenance and base operations support. The Army alone estimates that almost 60,000 contractor employees currently support ongoing military operations in Southwest Asia and has spent about \$15.4 billion on its single largest support contract—the Logistics Civil Augmentation Program (LOGCAP)—between 2001 and 2004.

Reconstruction and support contracts are often cost-reimbursement-type contracts, which allow the contractor to be reimbursed for reasonable, allowable, and allocable costs to the extent prescribed in the contracts. Further, these contracts often contain award fee provisions, which are intended to incentivize more efficient and effective contractor performance.<sup>3</sup> If contracts are not effectively managed and given sufficient oversight, the government's risk is likely to increase. For example, we have reported DOD needs to conduct periodic reviews of services provided under cost-reimbursement contracts to ensure that services are being provided and at an appropriate level and quality. Without such a review, the government is at risk to pay for services it no longer needs.

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## DOD Needs to Improve Its Capacity to Manage Contractors

DOD's reliance on contractors for key reconstruction efforts and support to deployed forces requires that DOD create the conditions conducive for success. Our work has shown that these conditions include a match between requirements and resources, sound acquisition approaches, leadership and guidance, visibility and knowledge of the number of contractors and the services they provide, and the capacity to manage and assess contractor performance. As we have previously reported, in many cases these conditions were not present on DOD reconstruction and support contracts, increasing the potential for fraud, waste, abuse, and mismanagement.

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<sup>3</sup>In December 2005, we reported that DOD programs engage in award fee practices that undermine efforts to motivate contractor performance and that do not hold contractors accountable for achieving desired acquisition outcomes. See GAO, *Defense Acquisitions: DOD Has Paid Billions in Award and Incentive Fees Regardless of Acquisition Outcomes*, [GAO-06-66](#) (Washington, D.C.: Dec. 19, 2005).



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Several of my colleagues in the accountability community and I have developed a definition of waste. As we see it, waste involves the taxpayers in the aggregate not receiving reasonable value for money in connection with any government funded activities due to an inappropriate act or omission by players with control over or access to government resources (e.g., executive, judicial or legislative branch employees, contractors, grantees or other recipients). Importantly, waste involves a transgression that is less than fraud and abuse. Further, most waste does not involve a violation of law, but rather relates primarily to mismanagement, inappropriate actions, or inadequate oversight. Illustrative examples of waste could include:

- unreasonable, unrealistic, inadequate or frequently changing requirements;
- proceeding with development or production of systems without achieving an adequate maturity of related technologies in situations where there is no compelling national security interest to do so;
- the failure to use competitive bidding in appropriate circumstances;
- an over-reliance on cost-plus contracting arrangements where reasonable alternatives are available;
- the payment of incentive and award fees in circumstances where the contractor's performance, in terms of costs, schedule and quality outcomes, does not justify such fees;
- the failure to engage in selected pre-contracting activities for contingent events;
- Congressional directions (e.g. earmarks) and agency spending actions where the action would not otherwise be taken based on an objective value and risk assessment and considering available resources.

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### Changing Requirements and Resources Complicate Efforts to Hold DOD and Contractors Accountable for Outcomes

A prerequisite to having good outcomes is a match between well-defined requirements and available resources. Shifts in priorities and funding, even those made for good reasons, invariably have a cascading effect on individual contracts, making it more difficult to manage individual projects to successful outcomes and complicate efforts to hold DOD and contractors accountable for acquisition outcomes. I should note such problems reflect some of the systemic and long-standing challenges

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confronting DOD, whether on contracts for services or major weapon systems. Contracts, especially service contracts, often do not have definitive or realistic requirements at the outset needed to control costs and facilitate accountability.

U.S. reconstruction goals were based on assumptions about the money and time needed, as well as a permissive security environment, all of which have proven unfounded. U.S. funding was not meant to rebuild Iraq's entire infrastructure, but rather to lay the groundwork for a longer-term reconstruction effort that anticipated significant assistance from international donors. To provide that foundation, the Coalition Provisional Authority (CPA) allocated \$18.4 billion in fiscal year 2004 reconstruction funds among various projects in each reconstruction sector, such as oil, electricity, and water and sanitation.<sup>4</sup> The CPA used a multitiered contracting approach to manage and execute the projects. In this case, the CPA, through various military organizations, awarded 1 lead contractor, 6 sector contractors, and 12 design-build contracts in early 2004 (see fig. 1).

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<sup>4</sup>From May 2003 through June 2004, the CPA was responsible for overseeing, directing, and coordinating rebuilding efforts.

**Figure 1: DOD Construction Program Carried Out through a Multitiered Contracting Approach**

**Top tier**

**Lead contractor**

provides overall direction and coordination to the sector and design-build contractors.

Program management office contract awarded to AECOM on March 10, 2004, contract ceiling of \$50 million

**Middle tier**

**Sector contractors**

provide planning, oversight, requirements definition, construction expertise, contract administration, and reporting.

**Security/  
justice**

Berger/URS:  
awarded 3/10/04,  
\$30 million ceiling

**Electricity**

Iraq Power Alliance  
awarded 3/10/04,  
\$55 million ceiling

**Oil sector**

Foster Wheeler  
awarded 3/10/04,  
\$30 million ceiling

**Public works  
and water**

CH2M Hill  
and PWI JV  
awarded 3/10/04,  
\$55 million ceiling

**Buildings/  
education/  
health**

Berger/URS  
awarded 3/10/04,  
\$15 million ceiling

**Communication  
and  
transportation**

Berger/URS  
awarded 3/10/04,  
\$15 million ceiling

**Lower tier**

**Design-build  
contractors**

are responsible for the design and execution of construction activities.

**Security/  
justice**

*Security/justice:*  
Parsons Delaware  
awarded 3/26/04,  
\$900 million ceiling

**Electricity**

*Generation:*  
Fluor/Amec  
awarded 3/11/04,  
\$500 million ceiling

*Transmission/  
distribution:*  
Washington Group  
Int. awarded 3/12/04,  
\$500 million ceiling

Perini Corporation  
awarded 3/12/04,  
\$500 million ceiling

**Oil sector**

*Northern Iraq:*  
Parsons Iraq JV  
awarded 1/16/04,  
\$800 million ceiling

*Southern Iraq:*  
KBR Inc.  
awarded 1/16/04,  
\$1.6 billion ceiling

**Public works  
and water**

*Public works:*  
Fluor/Amec North  
awarded 3/23/04,  
\$600 million ceiling

Fluor/Amec South  
awarded 3/23/04,  
\$500 million ceiling

*Water resources:*  
Washington Group  
Int./Black & Veatch  
awarded 3/11/04,  
\$600 million ceiling

**Buildings/  
education/  
health**

*Buildings,  
education, and  
health:*  
Parsons Delaware  
awarded 3/25/04,  
\$500 million ceiling

**Communication  
and  
transportation**

*Communication:*  
Lucent  
Technologies  
awarded 3/23/04,  
\$75 million ceiling

*Transportation:*  
Contrack  
awarded 3/23/04,  
\$325 million ceiling

Source: GAO.

After the CPA dissolved, the Department of State initiated an examination of the priorities and programs with the objectives of reprioritizing funding for projects that would not begin until mid- to late-2005 and using those funds to target key high-impact projects. By July 2005, the State Department had conducted a series of funding reallocations to address new priorities, including increased support for security and law enforcement efforts and oil infrastructure enhancements. One of the consequences of these reallocations was to reduce funding for the water and sanitation sector by about 44 percent, from \$4.6 billion to \$2.6 billion. One reallocation of \$1.9 billion in September 2004 led DOD's Project and Contracting Office to cancel some projects, most of which had been planned to start in mid-2005.

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Additionally, higher than anticipated costs associated with using the large design-build contracts contributed to DOD's decision to directly contract with Iraqi firms. For example, in the electricity sector, high cost estimates by one design-build contractor resulted in the termination of five task orders and the resolicitation of that work. After the task orders were canceled, the design-builder was slow to reduce overhead costs in accordance with the reduced workload, according to agency officials and documents. DOD is now directly contracting with Iraqi firms to reduce the costs of reconstruction efforts not requiring advanced technical and management expertise, such as erecting electrical distribution projects. Similarly, in the transportation sector, the design-build contractor demobilized and left Iraq shortly after award of the contract in March 2004 because DOD and the contractor agreed that the overall program costs were too high. Subsequently, DOD has made greater use of Iraqi contractors who were experienced in building roads and bridges.

Further, the lack of a permissive environment resulted in higher than anticipated security costs, which in turn, resulted in diverting planned reconstruction resources and led to canceling or reducing the scope of certain reconstruction projects. As we reported in July 2005, U.S. civilian agencies and the reconstruction contractors we evaluated generally obtained security services from private security providers.<sup>5</sup> We noted that the use of private security providers reflected, in part, the fact that providing security was not part of the U.S. military's stated mission. We also found, however, that despite significant role played by private security providers, U.S. agencies generally did not have complete data on the costs associated with their use. In June 2006, we reported that the agencies had agreed to include requirements for reconstruction contractors to report all costs for private security supplies and services that the contractor or any subcontractor may have to acquire necessary for successful contractor performance.<sup>6</sup>

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<sup>5</sup>GAO, *Rebuilding Iraq: Actions Needed to Improve Use of Private Security Providers*, [GAO-05-737](#) (Washington, D.C.: July 28, 2005).

<sup>6</sup>GAO, *Rebuilding Iraq: Actions Still Needed to Improve Use of Private Security Providers*, [GAO-06-865T](#) (Washington, D.C.: June 13, 2006).

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## DOD's Business Arrangements Contributed to Increased Risks on Individual Contracts

Agency procurement personnel generally had limited advance warning prior to awarding the initial reconstruction contracts and were uncertain as to the full scope of reconstruction activities that were required. The need to award contracts and begin reconstruction efforts quickly contributed to DOD using business arrangements that potentially increased DOD's risks. Such arrangements included allowing contractors to begin work before agreeing on what needed to be done and at what price and, during the initial stages of reconstruction, awarding contracts that were not awarded under full and open competition.

To produce desired outcomes within available funding and required time frames, DOD and its contractors need to clearly understand reconstruction objectives and how they translate into the contract's terms and conditions: the goods or services needed, the level of performance or quality desired, the schedule, and the cost. When requirements were not clear, DOD often entered into contract arrangements that posed additional risks, in particular by authorizing contractors to begin work before key terms and conditions, including the work to be performed and its projected costs, were fully defined. For example,

- In 2004, we issued two reports that identified a considerable amount of work that was being undertaken in Iraq as undefinitized contract actions.<sup>7</sup> For example, we reported that as of March 2004, about \$1.8 billion had been obligated on reconstruction contract actions without DOD and the contractors reaching agreement on the final scope and price of the work. Similarly, we found that as of June 2004, the Army and the contractor had definitized only 13 of the 54 task orders on the LOGCAP contract that required definitization. The lack of definitization contributed to the Army's inability to conduct award fee boards to assess the contractor's performance.<sup>8</sup>
- In September 2005, we reported that difficulties in defining the cost, schedule, and work to be performed associated with projects in the water sector contributed to project delays and reduced scopes of

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<sup>7</sup>GAO, *Rebuilding Iraq: Fiscal Year 2003 Contract Award Procedures and Management Challenges*, [GAO-04-605](#) (Washington, D.C.: June 1, 2004); and GAO, *Military Operations: DOD's Extensive Use of Logistics Support Contracts Requires Strengthened Oversight*, [GAO-04-854](#) (Washington, D.C.: July 19, 2004).

<sup>8</sup>The LOGCAP award fee process was also hindered because of the failure to finalize the award fee plan and to appoint individuals to serve on the award fee boards, as well as concerns that some customers had not been documenting their LOGCAP experiences.

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work.<sup>9</sup> We reported that DOD had obligated about \$873 million on 24 task orders to rebuild Iraq's water and sanitation infrastructure, including municipal water supplies, sewage collection systems, dams, and a major irrigation project. We found, however, that agreement between the government and the contractors on the final cost, schedule, and scope of 18 of the 24 task orders we reviewed had been delayed. These delays occurred, in part, because Iraqi authorities, U.S. agencies, and contractors could not agree on scopes of work and construction details. For example, at one wastewater project, local officials wanted a certain type of sewer design that increased that project's cost.

- In September 2006, we issued a report on how DOD addressed issues raised by the Defense Contract Audit Agency in audits of Iraq-related contract costs.<sup>10</sup> In particular, we found that DOD contracting officials were less likely to remove the costs questioned by auditors if the contractor had already incurred these costs before the contract action was definitized. In one case, the Defense Contract Audit Agency questioned \$84 million in an audit of a task order proposal for an oil mission. In this case, the contractor did not submit a proposal until a year after the work was authorized, and DOD and the contractor did not negotiate the final terms of the task order until more than a year after the contractor had completed the work. In the final negotiation documentation, the DOD contracting official stated that the payment of incurred costs is required for cost-type contracts, absent unusual circumstances. In contrast, in the few audit reports we reviewed where the government negotiated prior to starting work, we found that the portion of questioned costs removed from the proposal was substantial.

The need to award contracts and begin reconstruction efforts quickly—a contributing factor to DOD's use of undefinitized contract actions—also contributed to DOD using other than full and open competition during the initial stages of reconstruction. While full and open competition can be a tool to mitigate acquisition risks, DOD procurement officials had only a relatively short time—often only weeks—to award the first major

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<sup>9</sup>GAO, *Rebuilding Iraq: U.S. Water and Sanitation Efforts Need Improved Measures for Assessing Impact and Sustained Resources for Maintaining Facilities*, [GAO-05-872](#) (Washington, D.C.: Sept. 7, 2005).

<sup>10</sup>GAO, *Iraq Contract Costs: DOD Consideration of Defense Contract Audit Agency's Findings*, [GAO-06-1132](#) (Washington, D.C.: Sept. 25, 2006).

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reconstruction contracts. As a result, these contracts were generally awarded using other than full and open competition. We recently reported that our ability to obtain complete information on DOD reconstruction contract actions was limited because not all DOD components consistently tracked or fully reported this information. Nevertheless, for the data we were able to obtain, consisting of \$7 billion, or 82 percent, of DOD's total contract obligations between October 1, 2003, through March 31, 2006, DOD competed the vast majority of DOD's contract obligations.<sup>11</sup>

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## DOD Lacked the Capacity to Properly Manage and Assess Contractor Performance

An unstable contracting environment—when wants, needs, and contract requirements are in flux—also requires greater attention to oversight, which relies on a capable government workforce. Managing and assessing postaward performance entails various activities to ensure that the delivery of services meets the terms of the contract and requires adequate surveillance resources, proper incentives, and a capable workforce for overseeing contracting activities. If surveillance is not conducted, not sufficient, or not well documented, DOD is at risk of being unable to identify and correct poor contractor performance in a timely manner and potentially paying too much for the services it receives.

We and others have reported on the impact of the lack of adequate numbers of properly trained acquisition personnel and high turnover rates on reconstruction efforts. For example,

- Our June 2004 report found that early contract administration challenges were caused, in part, by the lack of a sufficient number of personnel.
- Our September 2005 report on water and sanitation efforts found that frequent staff turnover affected both the definitization process and the overall pace and cost of reconstruction efforts.
- The Special Inspector General for Iraq Reconstruction found that one of the CPA's critical shortcomings in personnel was the inadequate link between position requirements and necessary skills.
- In 2004, an interagency assessment team found that the number of contracting personnel was insufficient to handle the increased

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<sup>11</sup>GAO, *Rebuilding Iraq: Status of Competition for Iraq Reconstruction Contracts*, [GAO-07-40](#) (Washington, D.C.: Oct. 6, 2006).

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workload expected with the influx of fiscal year 2004 funding. In part, the CPA's decision to award seven contracts in early 2004 to help better coordinate and manage the fiscal year 2004 reconstruction efforts recognized this shortfall. As a result, however, DOD is relying on these contractors to help manage and oversee the design-build contractors.

DOD's lack of capacity contributed to challenges in using interagency contracting vehicles in Iraq. In certain instances, rather than develop and award its own contracts, DOD used contracts already awarded by other agencies. While this practice may improve efficiency and timeliness, these contracts need to be effectively managed, and their use requires a higher than usual degree of business acumen and flexibility on part of the workforce.

During the initial stages of reconstruction, we and the DOD Inspector General found instances in which DOD improperly used interagency contracts. For example, the Inspector General found that a DOD component circumvented contracting rules when awarding contracts on behalf of the CPA when using the General Services Administration's federal supply schedule. The Inspector General cited DOD's failure to plan for the acquisition support the CPA needed to perform its mission as contributing to this condition. Similarly, in April 2005 we reported that a lack of effective management controls—in particular insufficient management oversight and a lack of adequate training—led to breakdowns in the issuance and administration of task orders for interrogation and other services by the Department of the Interior on behalf of DOD.<sup>12</sup> These breakdowns included:

- issuing 10 out of 11 task orders that were beyond the scope of underlying contracts, in violation of competition rules;
- not complying with additional DOD competition requirements when issuing task orders for services on existing contracts;
- not properly justifying the decision to use interagency contracting;
- not complying with ordering procedures meant to ensure best value for the government; and

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<sup>12</sup>GAO, *Interagency Contracting: Problems with DOD's and Interior's Orders to Support Military Operations*, [GAO-05-201](#) (Washington, D.C.: Apr. 29, 2005).



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- not adequately monitoring contractor performance.

Because officials at Interior and the Army responsible for the orders did not fully carry out their roles and responsibilities, the contractor was allowed to play a role in the procurement process normally performed by the government. Further, the Army officials responsible for overseeing the contractor, for the most part, lacked knowledge of contracting issues and were not aware of their basic duties and responsibilities. In part, problems such as these contributed to our decision to designate management of interagency contracting a high-risk area in January 2005.

To improve its capacity to plan and award contracts and manage contractor performance, DOD has merged the Project and Contracting Office with the U.S. Army Corps of Engineers' Gulf Region Division. Additionally, DOD established the Joint Contracting Command-Iraq to consolidate and prioritize contracting activities and resolve contracting issues, among other things. As noted previously, DOD has also attempted to directly contract with Iraqi firms, rather than rely on the large U.S. design-build contracts that it had awarded in early 2004. Although DOD expects this approach will reduce costs, it will also likely increase the administrative and oversight burden on DOD's workforce.

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## DOD Needs Clear and Comprehensive Guidance and Leadership to Manage and Oversee Support Contractors

Since the mid-1990s, our reports have highlighted the need for clear and comprehensive guidance for managing and overseeing the use of contractors who support deployed forces. As we reported in December 2006, DOD has not yet fully addressed this long-standing problem.<sup>13</sup>

Such problems are not new. In assessing LOGCAP implementation during the Bosnian peacekeeping mission in 1997, we identified weaknesses in the available doctrine on how to manage contractor resources, including how to integrate contractors with military units and what type of management and oversight structure to establish.<sup>14</sup> We identified similar weaknesses when we began reviewing DOD's use of contractors in Iraq. For example, in 2003 we reported that guidance and other oversight

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<sup>13</sup>GAO, *Military Operations: High-Level DOD Action Needed to Address Long-standing Problems with Management and Oversight of Contractors Supporting Deployed Forces*, [GAO-07-145](#) (Washington, D.C.: Dec. 18, 2006).

<sup>14</sup>GAO, *Contingency Operations: Opportunities to Improve the Logistics Civil Augmentation Program*, [GAO/NSIAD-97-63](#) (Washington, D.C.: Feb. 11, 1997).

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mechanisms varied widely at the DOD, combatant command, and service levels, making it difficult to manage contractors effectively.<sup>15</sup> Similarly, in our 2005 report on private security contractors in Iraq, we noted that DOD had not issued any guidance to units deploying to Iraq on how to work with or coordinate efforts with private security contractors.<sup>16</sup> Further, we noted that the military may not have a clear understanding of the role of contractors, including private security providers, in Iraq and of the implications of having private security providers on the battle space.

Our prior work has shown that it is important for organizations to provide clear and complete guidance to those involved in program implementation. In our view, establishing baseline policies for managing and overseeing contractors would help ensure the efficient use of contractors in places such as Iraq. DOD took a noteworthy step to address some of these issues when it issued new guidance in 2005 on the use of contractors who support deployed forces. However, as our December 2006 report made clear, DOD's guidance does not address a number of problems we have repeatedly raised—such as the need to provide adequate contract oversight personnel, to collect and share lessons learned on the use of contractors supporting deployed forces, and to provide DOD commanders and contract oversight personnel with training on the use of contractors overseas prior to their deployment.

In addition to identifying the lack of clear and comprehensive guidance for managing contract personnel, we have issued several reports highlighting the need for DOD components to comply with departmental guidance on the use of contractors. For example, in our June 2003 report we noted that DOD components were not complying with a long-standing requirement to identify essential services provided by contractors and develop backup plans to ensure the continuation of those services during contingency operations should contractors become unavailable to provide those services. We believe that risk is inherent when relying on contractors to support deployed forces, and without a clear understanding of the potential consequences of not having the essential service available, the risks associated with the mission increase.

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<sup>15</sup>GAO, *Military Operations: Contractors Provide Vital Services to Deployed Forces but Are Not Adequately Addressed in DOD Plans*, [GAO-03-695](#) (Washington, D.C.: June 24, 2003).

<sup>16</sup>[GAO-05-737](#).

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In other reports, we highlighted our concerns over DOD's planning for the use of contractor support in Iraq—including the need to comply with guidance to identify operational requirements early in the planning process. When contractors are involved in planning efforts early, and given adequate time to plan and prepare to accomplish their assigned missions, the quality of the contractor's services improves and contract costs may be lowered. DOD's October 2005 guidance on the use of contractor support to deployed forces went a long way to consolidate existing policy and provide guidance on a wide range of contractor issues. However, as of December 2006, we found little evidence that DOD components were implementing that guidance, in part because no individual within DOD was responsible for reviewing DOD and service efforts to ensure the guidance was being consistently implemented.

We have made a number of recommendations for DOD to take steps to establish clear leadership and accountability for contractor support issues. For example, in our 2005 report on LOGCAP we recommended DOD designate a LOGCAP coordinator with the authority to participate in deliberations and advocate for the most effective and efficient use of the LOGCAP contract. Similarly, in our comprehensive review of contractors on the battlefield in 2006, we recommended DOD appoint a focal point within the Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics—at a sufficiently senior level and with the appropriate resources—dedicated to leading DOD's efforts to improve its contract management and oversight. DOD agreed with these recommendations. In October 2006, DOD established the office of the Assistant Deputy Under Secretary of Defense for Program Support to serve as the office of primary responsibility for contractor support issues, but the office's specific roles and responsibilities have not yet been clearly defined.

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## **Military Commanders and Senior DOD Leaders Need to Have Visibility over the Contractors Who Support Them**

DOD continues to lack the capability to provide senior leaders and military commanders with complete information on support provided by contractors to deployed forces. Without such visibility, senior leaders and military commanders cannot develop a complete picture of the extent to which they rely on contractors to support their operations. We first reported the need for better visibility in 2002 during a review of the costs associated with U.S. operations in the Balkans.<sup>17</sup> At that time, we reported

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<sup>17</sup>GAO, *Defense Budget: Need to Strengthen Guidance and Oversight of Contingency Operations Costs*, [GAO-02-450](#) (Washington, D.C.: May 21, 2002).

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that DOD was unaware of (1) the number of contractors operating in the Balkans, (2) the tasks those contractors were contracted to do, and (3) the government's obligations to those contractors under the contracts. We noted a similar situation in 2003 in our report on DOD's use of contractors to support deployed forces in Southwest Asia and Kosovo.<sup>18</sup> At that time, we reported that although most contract oversight personnel had visibility over the individual contracts for which they were directly responsible, visibility of all contractor support at a specific location was practically nonexistent at the combatant commands, component commands, and deployed locations we visited. As a result, commanders at deployed locations had limited visibility and understanding of all contractor activity supporting their operations and frequently had no easy way to get answers to questions about contractor support. This lack of visibility inhibited the ability of commanders to resolve issues associated with contractor support such as force protection issues and the provision of support to the contractor personnel.

Moreover, in our December 2006 review of DOD's use of contractors in Iraq, we found that DOD's continuing problems with limited visibility over contractors in Iraq unnecessarily increased contracting costs to the government and introduced unnecessary risk. Without visibility over where contractors are deployed and what government support they are entitled to, costs to the government may increase; for example, at a contractor accountability task force meeting we attended, an Army Materiel Command official noted that an Army official estimated that about \$43 million is lost each year on free meals provided to contractor employees at deployed locations who also receive a per diem food allowance. Also, when senior military leaders began to develop a base consolidation plan, officials were unable to determine how many contractors were deployed and therefore ran the risk of over- or under-building the capacity of the consolidated bases. DOD's October 2005 guidance on contractor support to deployed forces included a requirement that the department develop or designate a joint database to maintain by-name accountability of contractors deploying with the force and a summary of the services or capabilities they provide. The Army has taken the lead in this effort, and recently DOD designated a database intended to provide improved visibility over contractors deployed to support the military in Iraq, Afghanistan, and elsewhere.

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<sup>18</sup> [GAO-03-695](#).

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## DOD Lacks a Sufficient Number of Trained Contractor Management and Oversight Personnel

As I previously noted, having the capacity to manage and assess contractor performance is a critical factor in promoting successful outcomes, yet as we reported in December 2006, DOD does not have sufficient numbers of trained contractor management and oversight personnel at deployed locations. Such personnel include not only the contracting officers who award contracts, but also those personnel who define the requirements, receive or benefit from the services obtained, and monitor contractor performance. The lack of an adequate number of trained personnel limits DOD's ability to obtain a reasonable assurance that contractors are meeting contract requirements efficiently and effectively.

Several contract oversight personnel stated that DOD does not have adequate personnel at deployed locations to effectively oversee and manage contractors. For example, an Army official acknowledged that the Army is struggling to find the capacity and expertise to provide the contracting support needed in Iraq. In addition, officials responsible for contracting with Multinational Forces-Iraq stated that they did not have enough contract oversight personnel and quality assurance representatives to allow the organization to reduce the Army's use of the LOGCAP contract by awarding more sustainment contracts for base operations support in Iraq. Similarly, a LOGCAP program official noted that if adequate staffing had been in place, the Army could have realized substantial savings on the LOGCAP contract through more effective reviews of new requirements. Finally, the contracting officer's representative for an intelligence support contract in Iraq stated that he was unable to visit all of the locations that he was responsible for overseeing.

The inability of contract oversight personnel to visit all the locations they are responsible for can create problems for units that face difficulties resolving contractor performance issues at those locations. For example, officials from a brigade support battalion stated that they had several concerns with the performance of a contractor that provided maintenance for the brigade's mine-clearing equipment. These concerns included delays in obtaining spare parts and a disagreement over the contractor's obligation to provide support in more austere locations in Iraq. According to the officials, their efforts to resolve these problems in a timely manner were hindered because the contracting officer's representative was located in Baghdad while the unit was stationed in western Iraq. In other instances, some contract oversight personnel may not even reside within the theater of operations. For example, we found the Defense Contract Management Agency's (DCMA) legal personnel responsible for LOGCAP in Iraq were stationed in Germany, while other LOGCAP contract oversight

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personnel were stationed in the United States. According to a senior DCMA official in Iraq, relying on support from contract oversight personnel outside the theater of operations makes resolving contractor performance issues more difficult for military commanders in Iraq, who are operating under the demands and higher operational tempo of a contingency operation in a deployed location.

Our work has also shown the need for better predeployment training for military commanders and contract oversight personnel on the use of contractor support since the mid-1990s. Training is essential for military commanders because of their responsibility for identifying and validating requirements to be addressed by the contractor. In addition, commanders are responsible for evaluating the contractor's performance and ensuring the contract is performed in an economic and efficient manner. Similarly, training is essential for DOD contract oversight personnel who monitor the contractor's performance for the contracting officer.

As we reported in 2003, military commanders and contract management and oversight personnel we met in the Balkans and throughout Southwest Asia frequently cited the need for better preparatory training.<sup>19</sup> Additionally, in our 2004 review, we reported that many individuals using support contracts such as LOGCAP were unaware that they had any contract management or oversight roles.<sup>20</sup> Army customers stated that they knew nothing about LOGCAP before their deployment and that they had received no predeployment training regarding their roles and responsibilities in ensuring that the contract was used economically and efficiently. In 2005, we reported that military units did not receive specific predeployment training or guidance about working with private security providers. In our December 2006 report, we noted also that many officials responsible for contract management and oversight in Iraq told us they received little or no training on the use of contractors prior to their deployment, which led to confusion over their roles and responsibilities. For example, in several instances, military commanders attempted to direct or ran the risk of directing a contractor to perform work outside the scope of the contract, even though commanders are not authorized to do so. Such cases can result in increased costs to the government.

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<sup>19</sup> [GAO-03-695](#).

<sup>20</sup> [GAO-04-854](#).

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Over the years, we have made several recommendations to DOD intended to strengthen this training. Some of our recommendations were aimed at improving the training of military personnel on the use of contractor support at deployed locations, while others focused on training regarding specific contracts, such as LOGCAP, or the role of private security providers. Our recommendations have sought to ensure that military personnel deploying overseas have a clear understanding of the role of contractors and the support the military provides to them. DOD has agreed with most of our recommendations. However, we continue to find little evidence that DOD has improved training for military personnel on the use of contractors prior to their deployment.

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## A Deteriorating Security Situation Continues to Hamper Reconstruction Efforts

The security situation continues to deteriorate, impeding the management and execution of reconstruction efforts. To improve this condition, the United States is, among other things, (1) training and equipping Iraqi security forces that will be capable of leading counterinsurgency operations, and (2) transferring security responsibilities to Iraqi forces and the Iraqi government as capabilities improve. Although progress has been made in transferring more responsibilities to the Iraqi security forces, the capabilities of individual units are uncertain.

Since the fall of 2003, the U.S.-led multinational force in Iraq has developed and refined a series of plans to transfer security responsibilities to the Iraqi government and security forces, with the intent of creating conditions that would allow a gradual drawdown of the 140,000 U.S. military personnel in Iraq. This security transition was to occur first in conjunction with the neutralization of Iraq's insurgency and second with the development of Iraqi forces and government institutions capable of securing their country.

DOD and the State Department have reported progress in implementing the current security transition plan. For example, the State Department has reported that the number of trained and equipped Iraqi army and police forces has increased from about 174,000 in July 2005 to about 323,000 in December 2006. DOD and the State Department also have reported progress in transferring security responsibilities to Iraqi army units and provincial governments. For example, the number of Iraqi army battalions in the lead for counterinsurgency operations has increased from 21 in March 2005 to 89 in October 2006. In addition, 7 Iraqi army division headquarters and 30 brigade headquarters had assumed the lead by December 2006. Moreover, by mid-December 2006, three provincial

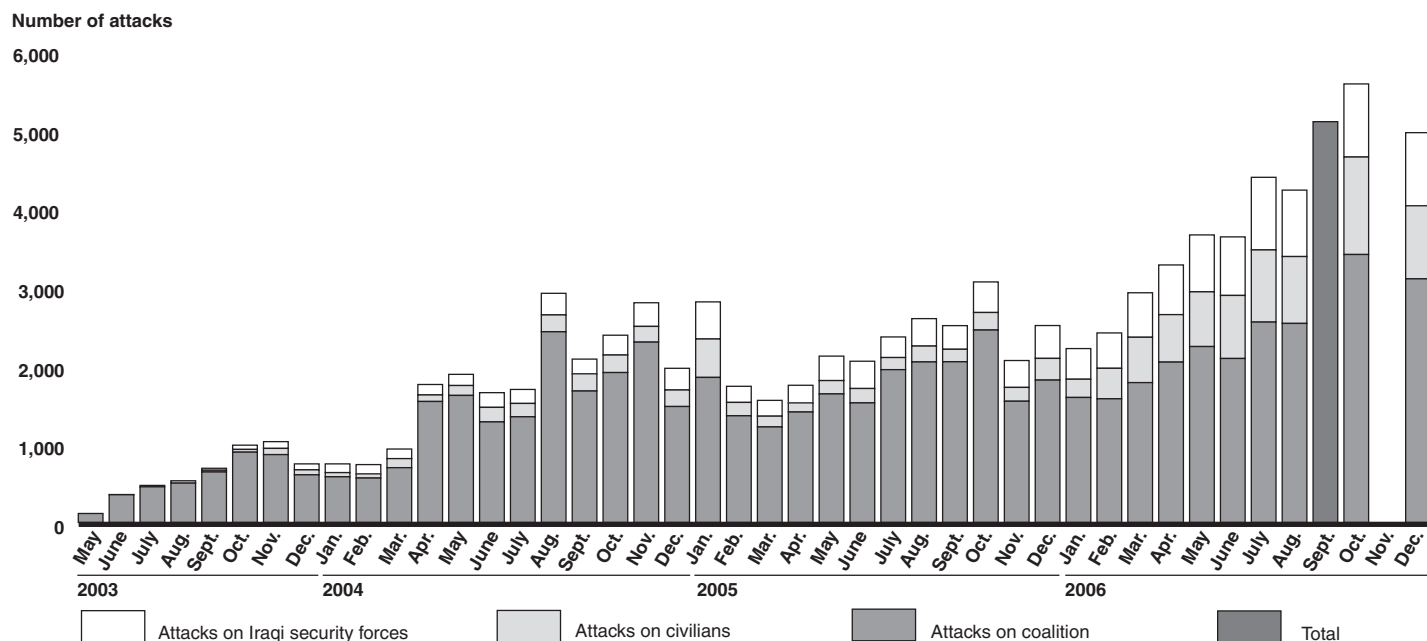
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governments—Muthanna, Dhi Qar, and Najaf—had taken over security responsibilities for their provinces.

The reported progress in transferring security responsibilities to Iraq, however, has not led to improved security conditions. Since June 2003, overall security conditions in Iraq have deteriorated and grown more complex, as evidenced by the increased numbers of attacks and more recent Sunni-Shi'a sectarian strife after the February 2006 bombing of the Golden Mosque in Samarra (see figure 2). Enemy-initiated attacks against the coalition and its Iraqi partners have continued to increase during 2006. For example, the average total attacks per day increased from about 70 per day in January 2006 to about 180 per day in October 2006. In December 2006, the attacks averaged about 160 per day. These attacks have increased around major religious and political events, such as Ramadan and elections. Coalition forces are still the primary target of attacks, but the number of attacks on Iraqi security forces and civilians also has increased since 2003. In October 2006, the State Department reported that the recent increase in violence has hindered efforts to engage with Iraqi partners and shows the difficulty in making political and economic progress in the absence of adequate security conditions.



**Figure 2: Enemy-Initiated Attacks against the Coalition and Its Iraqi Partners**



Note: An unclassified breakout of attacks by category is not available for September 2006, and an unclassified number of attacks is not available for November 2006.

Further, because of the level of violence in Iraq, the United States has not been able to draw down the number of U.S. forces in Iraq as early as planned. For example, after the increase in violence and collapse of Iraqi security forces during the spring of 2004, DOD decided to maintain a force level of about 138,000 troops until at least the end of 2005, rather than reducing the number of troops to 105,000 by May 2004, as had been announced the prior fall. Subsequently, DOD reversed a decision to significantly reduce the U.S. force level during the spring of 2006 because Iraqi and coalition forces could not contain the rapidly escalating violence that occurred the following summer. Moreover, rather than moving out of urban areas, U.S. forces have continued to conduct combat operations in Baghdad and other cities in Iraq, often in conjunction with Iraqi security forces. As you know, DOD is in the process of providing additional forces to help stem violence in Iraq.

Understanding the true capabilities of the Iraqi security forces is essential for the Congress to make fully informed decisions in connection with its authorization, appropriations, and oversight responsibilities. DOD and

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State provide Congress with weekly and quarterly reports on the progress made in developing capable Iraqi security forces and transferring security responsibilities to the Iraqi army and the Iraqi government. This information is provided in two key areas: (1) the number of trained and equipped forces, and (2) the number of Iraqi army units and provincial governments that have assumed responsibility for security of specific geographic areas.

The aggregate nature of these reports, however, does not provide comprehensive information on the capabilities and needs of individual units. This information is found in unit-level Transition Readiness Assessment (TRA) reports. The TRA is a joint assessment, prepared monthly by the unit's coalition commander and Iraqi commander. According to Multinational Force-Iraq guidance, the purpose of the TRA system is to provide commanders with a method to consistently evaluate units; it also helps to identify factors hindering unit progress, determine resource shortfalls, and make resource allocation decisions. These reports provide the coalition commander's professional judgment on an Iraqi unit's capabilities and are based on ratings in personnel, command and control, equipment, sustainment and logistics, training, and leadership. These reports also serve as the basis for the Multinational Force-Iraq's determination of when a unit is capable of leading counterinsurgency operations and can assume security responsibilities for a specific area.

DOD provided GAO with classified, aggregate information on overall readiness levels for the Iraqi security forces—including an executive-level brief—and information on units in the lead, but has not provided unit-level reports on Iraqi forces' capabilities. GAO has made multiple requests for access to the unit-level TRA reports since January 2006. Nevertheless, as of last week, DOD still had not provided GAO unit-level TRA data, thereby limiting oversight over the progress achieved toward a critical objective.

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## The Iraqi Government Currently Lacks the Capacity to Sustain and Continue Reconstruction and Security Efforts

While the United States has spent billions of dollars rebuilding the infrastructure and developing Iraqi security forces, U.S. and World Bank assessments have found that the Iraqi government's ability to sustain and maintain reconstruction efforts is hindered by several factors, including the lack of capacity in Iraq's key ministries and widespread corruption, and the inability of the Iraqi government to spend its 2006 capital budget for key infrastructure projects.

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## Despite Some Progress, Concerns about Ministries' Capacity and Widespread Corruption Hinder Reconstruction Efforts

The United States has invested about \$14 billion to restore essential services by repairing oil facilities, increasing electricity generating capacity, and restoring water treatment plants. For example, the U.S. Army Corps of Engineers reported that it had completed 293 of 523 planned electrical projects, including the installation of 35 natural gas turbines in Iraqi power generation plants. Additionally, reconstruction efforts have rebuilt or renovated schools, hospitals, border forts, post offices, and railway stations. Despite these efforts, a considerable amount of planned reconstruction work is not yet completed. DOD estimated that as of October 8, 2006, about 29 percent of the planned work remained to be completed, including some work that will not be completed until mid-to late 2008.

The Iraqi government has had difficulty operating and sustaining the aging oil infrastructure and maintaining the new and rehabilitated power generation facilities. For example,

- Iraq's oil production and exports have consistently fallen below their respective program goals. In 2006, oil production averaged 2.1 million barrels per day, compared with the U.S. goal of 3.0 million barrels per day. The Ministry of Oil has had difficulty operating and maintaining the refineries. According to U.S. officials, Iraq lacks qualified staff and expertise at the field, plant, and ministry levels, as well as an effective inventory control system for spare parts. According to the State Department, the Ministry of Oil will have difficulty maintaining future production levels unless it initiates an ambitious rehabilitation program. In addition, oil smuggling and theft of refined oil products have cost Iraq substantial resources.
- In 2006, electrical output reached 4,317 megawatts of peak generation per day, falling short of the U.S. goal of 6,000 megawatts. Prewar electrical output averaged 4,200 megawatts per day. Production also was outpaced by increasing demand, which has averaged about 8,210 megawatts per day. The Iraqi government has had difficulty sustaining the existing facilities. Problems include the lack of training, inadequate spare parts, and an ineffective asset management and parts inventory system. Moreover, plants are sometimes operated beyond their recommended limits, resulting in longer downtimes for maintenance. In addition, major transmission lines have been repeatedly sabotaged, and repair workers have been intimidated by anti-Iraqi forces.

In part, these shortfalls can be traced to the lack of capacity within Iraq's central government ministries. Iraqi government institutions are

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undeveloped and confront significant challenges in staffing a competent, non-aligned civil service; using modern technology and managing resources effectively; and effectively fighting corruption. According to U.S. and World Bank assessments, ministry personnel are frequently selected on the basis of political affiliation rather than competence or skills, and some ministries are under the authority of political parties hostile to the U.S. government. The Iraqi ministries also lack adequate technology and have difficulty managing their resources and personnel. For example, the World Bank reports that the Iraqi government pays salaries to nonexistent, or ghost, employees that are collected by other officials. According to U.S. officials, 20 to 30 percent of the Ministry of Interior staff are ghost employees.

Further, corruption in Iraq is reportedly widespread and poses a major challenge to building an effective Iraqi government and could jeopardize future flows of needed international assistance. For example, a World Bank report notes that corruption undermines the government's ability to make effective use of current reconstruction assistance. A 2006 survey by Transparency International ranked Iraq's government as the second most corrupt government in the world. Moreover, between January 2005 and August 2006, 56 officials in Iraq's ministries were either convicted of corruption charges or subject to arrest warrants.

According to U.S. government and World Bank reports, the reasons for corruption in the Iraqi ministries are several, including the following:

- the absence of an effective Iraqi banking system leaves the government dependent on cash transactions;
- the majority of key Iraqi ministries have inadequately transparent, obsolete, or ambiguous procurement systems; and
- key accountability institutions, such as the inspectors general who were installed in each Iraqi ministry in 2004, lack the resources and independence to operate effectively and consistently.

Corruption is also pervasive in the oil sector, a critical source of revenue for the Iraqi government. In 2006, the World Bank and the Ministry of Oil's Inspector General estimated that millions of dollars of government revenue is lost each year to oil smuggling or diversion of refined products. According to State Department officials and reports, about 10 percent to 30 percent of refined fuels is diverted to the black market or is smuggled out of Iraq and sold for a profit. According to U.S. embassy documents, the

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insurgency has been partly funded by corrupt activities within Iraq and from skimming profits from black marketers. In addition, Iraq lacks fully functioning meters to measure oil production and exports, precluding control over the distribution and sale of crude and refined products.

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### Iraq Has Spent Little of Its Annual Capital Budget to Help Support Reconstruction Efforts

Sound government budgeting practices can help determine the priorities of the new government, provide transparency on government operations, and help decision makers weigh competing demands for limited resources. However, unclear budgeting and procurement rules have affected Iraq's efforts to spend capital budgets effectively and efficiently, according to U.S. officials. The inability to spend the funds raises serious questions for the government, which has to demonstrate to skeptical citizens that it can improve basic services and make a difference in their daily lives. The U.S. government has launched a series of initiatives in conjunction with other donors to address this issue and improve the Iraqi government's budget execution.

When the Iraqi government assumed control over its finances in 2004, it became responsible for determining how more than \$25 billion annually in government revenues would be collected and spent to rebuild the country and operate the government. Unclear budgeting and procurement rules have affected Iraq's efforts to spend capital budgets effectively and efficiently, according to U.S. officials. As of August 2006, the government of Iraq had spent, on average, 14 percent of its 2006 capital projects budget (Iraq's fiscal year begins on January 1 of each year). Some of the lowest rate of spending occurs at the Ministry of Oil, which relies on damaged and outdated infrastructure to produce the oil that provides nearly all of the country's revenues (see table 1).

**Table 1: Iraq's 2006 Budget and Actual Expenditures through August 2006**

Dollars in millions						
Ministry	2006 annual budget			Expenditures through August 2006		
	Capital goods	Capital projects	Total budget	Capital goods	Capital projects	Total budget
Finance	\$10	\$33	\$16,506	\$1	\$74	\$8,895
Planning	4	27	55	0.4	3	9
Interior	233	27	1,919	25	0.2	958
Defense	864	33	3,443	12	0.0	831
Oil	2	3,533	3,590	0.4	4	40
Electricity	4	767	840	0.3	267	279
Water	0.2	200	259	0.0	49	78
Justice	3	10	74	2	0.2	34
Others	272	1,552	7,290	77	480	3,501
<b>Total</b>	<b>\$1,392</b>	<b>\$6,181</b>	<b>\$33,975</b>	<b>\$117 (8.4%)</b>	<b>\$877 (14.2%)</b>	<b>\$14,623 (43.0%)</b>

Source: GAO analysis of Iraqi budget data.

Since most of the \$34.5 billion in reconstruction funds provided between fiscal years 2003 and 2006 have been obligated, unexpended Iraqi funds represent an important source of additional financing. The capital goods budgets of the Interior and Defense ministries were intended for the purchase of weapons, ammunition, and vehicles, among other items. However, as of August 2006, Interior and Defense had spent only about 11 percent and 1 percent, respectively, of these budgeted funds.

Further, according to U.S. and foreign officials, the ability of the Iraqi government to fund improvements in its oil and electricity sectors remain uncertain. For example, the Ministry of Oil has had difficulty operating and maintaining its aging infrastructure, including some refineries originally constructed in the 1950s, 1960s, and 1970s. While the Ministry of Oil's \$3.5 billion 2006 capital project's budget targeted key enhancements to the country's oil production, distribution, and export facilities, as of August 2006, the ministry had spent less than 1 percent of these budgeted funds.

Similarly, Iraq's electricity sector suffers from deteriorated, outdated, and inefficient infrastructure resulting from two decades of underinvestment in operations and maintenance, replacement, and expansion. This weakened infrastructure has led to unplanned outages. Despite the Ministry of Electricity's recent development of a 10-year master plan, Iraq's ability to fund improvements in its electricity sector remains uncertain. This uncertainty is due to low electricity tariffs, uncertain donor

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commitments, and according to a World Bank assessment, an inadequate legal and regulatory framework.

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## Concluding Observations

As I have discussed today, there are a number of conditions that exist in Iraq that have led to, or will lead to, increased risk of fraud, waste, and abuse of U.S. funds. DOD's extensive reliance on contractors to undertake reconstruction projects and provide support to deployed forces requires DOD to address long-standing challenges in an aggressive, effective manner. This reliance raises a broader question as to whether DOD has become too dependent on contractors to provide essential services without clearly identifying roles and responsibilities, and employing appropriate oversight and accountability mechanisms.

Continuing reconstruction progress will require overall improvement in the security situation in Iraq. To do so, Iraqi security forces and provincial governments must be in a position to take responsibility for the security of their nation. At this time, their capacity to do so is questionable. Furthermore, the U.S. and the international community will need to support the Iraqi government's efforts to enhance its capacity to govern effectively and efficiently if it is to make a positive difference in the daily lives of the Iraqi people.

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Mr. Chairman, this concludes my statement. I would be pleased to answer any questions that you or other members may have at this time.

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## GAO Contacts and Acknowledgments

For questions regarding this testimony, please call Katherine V. Schinasi at (202) 512-4841. Other contributors to this statement were Ridge Bowman, Daniel Chen, Joseph Christoff, Carole Coffey, Lynn Cothorn, Timothy DiNapoli, Whitney Havens, John Hutton, John Krump, Steve Lord, Steve Marchesani, Tet Miyabara, Judy McCloskey, Mary Moutsos, Ken Patton, Jim Reynolds, and William Solis.

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